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PACIFIC X TELESIS
Group - Washington

January 31, 1994

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

**Re: RM 8388 - NYNEX Transition Plan to Preserve Universal Service in a
Competitive Environment**

**On behalf of Pacific Bell and Nevada Bell, please find enclosed an original and six
copies of their "Comments" in the above proceeding.**

**Please stamp and return the provided copy to confirm your receipt. Please contact me
should you have any questions or require additional information concerning this matter.**

Sincerely,

William F. Adler
WA

Enclosures

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from AT&T's switches for all calls placed by subscribers to these services.

MCI has recently announced plans to spend about \$20 billion to build local networks in 20 major cities over the next two years. MCI's strategy is three-fold: supply itself with the access service it now buys from us, and reduce its access costs by 20 to 30 cents out of each revenue dollar; resell excess capacity to other IXCs such as AT&T and Sprint; and, of course, supply end-to-end service directly to end users, also in competition with us.¹ It is only the Commission's separations and access charge rules that make this an easy decision for MCI. Without these rules, which raise switched access prices in metropolitan markets substantially above their real cost, there is no telling whether MCI's \$20 billion investment would make sense.

Even without full competition, our share of the switched access market is shrinking. Our competitors can make great inroads into our markets with little investment by undercutting our geographically averaged rates in just a few wire centers. We understand that as of this date, a majority of the collocation requests nationwide have been filed in our territory, which reflects the high concentration (and vulnerability) of our markets. The orders for collocation that we have received to date will give the CAPs access to offices with nearly half of

¹ See "MCI Is Planning Local Networks in Major Cities," Wall Street Journal, Thursday, Dec. 30, 1993, p. A3.

Pacific's interstate transport services (special and switched). We expect expanded interconnection for switched access, which will increase the downward pressure on switched access prices, to follow much the same pattern. Once expanded interconnection is combined with intraLATA competition, CAPs can combine their existing hicap networks with switches from LECs or others to provide intraLATA toll service that is fully competitive with the ours. MFS already does so in New York, where MFS's Intellenet subsidiary holds itself out as a "full-service" provider of integrated local, long distance, and IN services including least-cost routing, 800 service, voice mail, and facilities management, as well as customized billing and management reports.²

As MFS itself said in its Comments in Docket 91-141, "MFS believes it is inevitable that non-LECs will begin providing subscriber loops and competitive local switching in some markets within the relatively near future."³ The "relatively near future" has arrived. In a November 1993 Report to the Governor on infrastructure, the California Public Utilities Commission called for full local competition, including the provision of local exchange access, within three years. Although this may seem ambitious, the market is ahead of the CPUC. Bell Atlantic,

² "MFS Rolls Out Integrated Local/Long Distance Service Package in New York," Telco Competition Report, vol. 2, No. 19 (Oct. 14, 1993).

³ Comments of MFS Communications Company, Inc., Docket 91-141, Phase II, filed April 2, 1993.

US West, Southwestern Bell, and NYNEX have all integrated with cable companies. They now own fiber and coaxial distribution systems running past most California customers, and their stated intention is to bring these customers interactive services, including local telephone service. Through TCI/Bell Atlantic, TCG will have access to over 30% of the California market and 59 of the top 100 markets nationwide. These "supercarriers" have their own SONET/fiber networks, their own switches, their own video services and their own PCS frequencies. The CAPs are also installing their own switches, and we estimate that MFS and Teleport alone have enough fiber capacity installed in the Los Angeles and San Francisco downtown areas to handle all of our switched traffic there.

These facts throw a monkey wrench in the Commission's rules. Both the states and the Commission have subsidized basic exchange access. Under the Commission's rules, significant non-traffic sensitive (NTS) costs are allocated to the carrier common line (CCL) element and recovered through traffic sensitive charges. This rule sends distorted price signals to consumers (it subsidizes and encourages universal access, while uneconomically discouraging use of switched access). When the current rules were adopted, the potential for uneconomic bypass that result from recovering some NTS costs in carrier rates was weighed against the important social purpose of encouraging

universal access to the network, and found to be worthwhile.⁴ But the whole arrangement depended on the ability of local carriers to recover the NTS subsidy in their access charges.

What NYNEX's petition demonstrates is that due to competition, recovery of this NTS subsidy is no longer assured. The current separations and access rules no longer work because they were premised on the absence of competition. Customers cannot reward the most efficient providers by purchasing their services. Potential providers receive incorrect signals of their ability to produce services more efficiently than current providers. The level of competition is not uniform across the nation. Some state regulators have allowed far more competition than others, and some markets are more attractive than others. While the degree of competition varies, the Commission's rules continue to assume that all study areas are created equal.

The rules need to be revised, among other reasons to recognize the vastly different degrees of competition that different carriers already face. There is no justification for the Commission to wait for further harm to occur before it revisits the recovery of the NTS subsidy. Rational customers take anticipated competition into account when they make business plans. Hence, the Justice Department's 1992 Merger Guidelines

⁴ See MCI v. FCC, 750 F.2d 135 (D.C. Cir. 1984); MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 78-72, 80-286, CC 1001, Recommended Decision and Order, released November 23, 1984, paras. 26-27; Decision and Order, FCC 84-637, released December 28, 1984, para. 8.

consider potential competitive entry to be relevant to market power if it is expected to occur within a two year period.⁵

In the short run, the Commission should expeditiously grant waivers of rules that have anti-competitive effects on particular carriers. NYNEX appears to have made such a case. The rules do not just cause efficiency losses to consumers. They threaten recovery of the NTS subsidy, because customers can avoid contributing to NTS costs by changing carriers. In the long run, the Commission should carefully define what services and what customers really deserve to be subsidized. The ideal mechanism for recovering subsidies would be one that customers could not avoid by shifting from one carrier to another, as they can now avoid the CCL charge. This would minimize any competitive distortions within the telecommunications industry. It is likely that there would still be markets with such high costs that carriers would have no natural incentive to provide service to them. An artificial incentive to serve such markets would be justified. Carriers of last resort who provide service to a market below cost should be fairly compensated for providing it.

Proposals such as NYNEX's are appropriate in the short run to preserve sources of contribution to universal service. However, it will not suffice for the long run. Competitive markets benefit from less rather than more regulatory oversight, which demands revision of the access and separations rules. We

⁵ 1992 Merger Guidelines, Section 3.2, reprinted at 4 Trade Reg. Rep. (CCH), paras. 13, 104.

look forward to providing more detailed information in the
upcoming review of the price cap rules.

Respectfully submitted,

PACIFIC BELL
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